Operations Consultation
Electricity Authority
via email
OperationsConsult@ea.govt.nz

28 November 2024

Update to scarcity pricing settings

Thank you for the opportunity to submit on the "Update to scarcity pricing settings" consultation paper (Consultation).

Mercury is very supportive of the Authority's proposal to update scarcity pricing settings. We agree that scarcity prices need to be raised to ensure they properly reflect the value of reliability to consumers, and the Consultation represents a step in the right direction.

We will simultaneously be responding to Transpower's consultation on "System Operator co-ordination of Low Residual Situations" however the feedback we will be providing to Transpower is also relevant to this Consultation. The recent events of 10 May 2024 and saw Transpower issuing text messages to generators and public statements[1] expressing concern about the forecast high demand and potential lack of capacity to respond adequately to that demand. This type of messaging, that falls outside usual system operator processes, can have a negative impact on scarcity signals. If demand is curtailed because of public messaging, this may artificially suppress the price signal that would normally indicate scarcity. Further, if market participants perceive that there will be frequent interventions to stop prices rising to scarcity levels during a shortage event, they will become concerned around revenue adequacy and less inclined to invest in new flexible generation and or to upgrade existing generation. Ultimately, an over reliance on out of market directions to curtail demand undermines the reliability of price signals which are crucial for long-term planning and stability.

Our overriding submission is therefore that the Authority must ensure that its rules allow prices to go to scarcity so the market can incentivise the behaviour and investment that is required to build generation capacity, demand response and other supply-side initiatives. This should also be coupled with a structured information programme for wider stakeholders on how the market works to ensure understanding of the market, including that high prices at times of scarcity are a feature of the market design not a bug. This is fundamental for ensuring broader confidence in the market is maintained and aligned with Recommendation 22 of the MDAG work.

Our answers to the Consultation questions are attached at Appendix A.

Please do not hesitate to contact me on 0212882276 or at jo.christie@mercury.co.nz if you have any queries in relation to our submission.

Yours sincerely

Jo Christie
Regulatory Strategist

[1] Transpower media release 1.30pm 9 May 2024

Appendix A: Mercury submission

Questions	Comments
Q1. Do you support the proposal to raise energy scarcity prices? Please explain your answer.	Yes, Mercury supports this proposal. The proposed higher energy scarcity prices better reflect the value of lost load (VoLL) to consumers and and will better support operational coordination (including unit commitment decisions) and will promote efficient pricing, which is important overtime to support efficient consumption and investment decisions.
Q2. Do you support the proposal to set energy scarcity prices at values consistent with 2018 VoLL ($17,000/MWh, $25,000/MWh and $40,000/MWh)? Please explain your answer.	Yes, Mercury supports the higher values however we note that the Authority has referenced Transpower's 2018 study into the VoLL to determine appropriate values for energy scarcity. There has been a significant time lag since this study and we therefore question whether those 2018 figures are still valid. Whilst the Authority is required to update or review energy scarcity prices every 5 years[2] the same requirement does not exist for the VoLL. [3] In other jurisdictions, electricity regulators must update their estimates of VoLL every five years and may not set a scarcity price that is below VoLL. This is to avoid periods when electricity is not supplied even though the benefit to consumers would exceed the cost of supply.[4] We strongly support the Authority's priority review of the VoLL in 2025[5] and we recommend: 1. obligatory review of the VoLL at least every 5 years in line with energy scarcity prices to ensure they remain relevant. How these values are calculated and how frequently they are updated is critical to whether the market will clear in the long-term interest of consumers given the effect they have on investment in technologies that support capacity margins. 2. the proposed energy and reserve scarcity price should not be finalised until the Authority has reviewed the VoLL, as discussed above.
Q3. Do you support the proposal to reduce the number of reserve scarcity prices from three tranches to one tranche? Please explain your answer.	Yes, we support the reduction of reserve scarcity prices from three tranches to one tranche.

[2] Clause 13.58AB of the Code.
[3] The VoLL in the Code dates from late 2004.
[4] ACER. (2022). *Security of EU electricity supply in 2021: Report on Member States approaches to assess and ensure adequacy*. European Union Agency for the Cooperation of Energy Regulators. https://acer.europa.eu/sites/default/files/documents/Publications/ACER_Security_of_EU_Electricity_Supply_2021.pdf
[5] Paragraph 4.29 of the Consultation.

Q4. Do you support the proposal to set reserve scarcity prices at $4,000/MWh for FIR and $3,500/MWh for SIR? Please explain your answer.	Mercury recommends more consideration be given to setting the reserve scarcity prices for FIR and SIR. In our view, the proposed $4000/MWh for FIR and $3500/MWh for SIR are arbitrary numbers based on the assumption that the current maximum energy offer price of $6,000/MWh will remain constant. Energy offer prices are fluid subject to fuel, technology type, and operational constraints. Additionally, market participants generally manage their energy, and reserve offers with relativity to each other. Setting reserve scarcity prices too low risks artificially holding down prices. This could become an issue in the future as evidence shows that reserve prices will more frequently set the wholesale market price.[6] We urge the Authority to further investigate these settings or at least provide more justification for the proposed levels.
Q5. Do you support the proposal to raise the price of controllable load to $16,000/MWh? Please explain your answer.	Yes, although see our comments above at question 2. The price of controllable load would need to align with the scarcity price that reflects an updated VoLL.
Q6. Do you have any comments on the drafting of the proposed amendment?	No comment.
Q7. Do you agree the proposed amendment is preferable to the other options? If you disagree, please explain your preferred option in terms consistent with the Authority's statutory main objective in section 15 of the Electricity Industry Act 2010.	We are unsure as to whether the proposed amendment is preferable to the other options and reiterate our comments in response to questions 2 and 4. Whilst we support raising scarcity prices we recommend the Authority: • Consider reviewing the VoLL more regularly in line with energy scarcity prices so that the value accurately reflects long term consumer interests; and • Investigate potential unintended consequences of setting reserve scarcity prices too low and/or provide further justification for proposed reserve scarcity price levels.
Q8. Do you agree with the analysis presented in this Regulatory Statement? If not, why not?	Yes, Mercury agrees with the analysis.

[6] Paragraph 5.24 of the Consultation.